Supreme Court
FILED
JUN 28 1999
OFFICE OF THE CLERK

Docket Number 99 293

**SUPREME COURT OF THE UNITED STATES**

In The Matter of INTELOGIC TRACE, INC.,

Debtor.

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ROBERT SACHS, et al.,

Petitioners,

v.

INTELOGIC TRACE, INC., et al.,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

# PETITION FOR WRIT OF CERTIORARI

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136pp

## QUESTIONS PRESENTED FOR REVIEW

1. Did the lower court err in holding that "no recourse" language contained in a corporate debenture was an absolute bar to holding corporate officers and directors individually liable for acts of affirmative negligence and fraud that caused the corporation to breach its contractual obligation to pay interest under the debenture?

2. Did the lower court err in holding that no set of facts could be proved in support of petitioners' claims for negligence, common law fraud, and statutory securities fraud against a corporation and its directors that were not barred by the statute of limitations?

## LIST OF PARTIES TO THE PROCEEDING

| | |
|---|---|
| Robert Sachs | Petitioner |
| Nibco Nevada, Inc. | Petitioner |
| Karen Sachs | Petitioner |
| Claudia Sachs | Petitioner |
| Howard Yonet | Petitioner |
| Joseph Corda | Petitioner |
| Toma Corda | Petitioner |
| Elizabeth J. Sampson & Associates | Petitioner |
| Yony Properties, Inc. | Petitioner |
| Henri Yonet | Petitioner |
| Paul Yonet | Petitioner |
| Larry Wayne | Petitioner |
| Anne Wayne | Petitioner |
| Noam Schwartz | Petitioner |
| Marion Blackburn | Petitioner |
| Lois Esformes | Petitioner |
| Mary Ann McCain | Petitioner |
| Stan Cohen | Petitioner |
| Carol Seiden | Petitioner |

| | |
|---|---|
| Sachs Living Trust | Petitioner |
| Herbert H. Eveloff, M.D. | Petitioner |
| Herbert H. Eveloff, M.D.,IRA | Petitioner |
| Peter Kaltman | Petitioner |
| Faye Eveloff | Petitioner |
| NEO Construction, Inc. | Petitioner |
| Gary Austin | Petitioner |
| L.F.I. Retirement Trust | Petitioner |
| Kay F. Gerhard | Petitioner |
| Gary Pollack | Petitioner |
| Intelogic Trace, Inc. | Respondent |
| Asher B. Edelman | Respondent |
| Clark R. Mandigo | Respondent |
| Leon Botstein | Respondent |
| Henry G. Cisneros | Respondent |
| Daniel R. Kail | Respondent |
| Burton Lehman | Respondent |
| Michael D. Schultz | Respondent |
| Dwight D. Sutherland | Respondent |

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## CITATION OF UNOFFICIAL REPORT OF ORDER ENTERED IN THE CASE

Sachs, et al. v. Intelogic Trace, Inc., et al., (Opinion 2/22/99, 5 Cir., _____, F.3d _____).

## STATEMENT OF BASIS FOR JURISDICTION IN THE SUPREME COURT OF THE UNITED STATES

The date of entry of the order of the United States Court of Appeals for the Fifth Circuit sought to be reviewed is February 22, 1999.

The date of entry of the order of the United States Court of Appeals for the Fifth Circuit denying rehearing of the order sought to be reviewed is March 29, 1999.

The statutory provision that confers jurisdiction on the Supreme Court of the United States to review on a writ of certiorari the order dated February 22, 1999 is Rule 10, Rules of the Supreme Court of the United States.

## STATUTES INVOLVED IN THE CASE

Federal Rules of Bankruptcy Procedure Rule 7009

Federal Rules of Bankruptcy Procedure Rule 7012

Federal Rules of Civil Procedure 9(b)

Federal Rules of Civil Procedure 12(b)(6)

## STATEMENT OF THE CASE

1. PROCEDURAL BACKGROUND.

Petitioners are twenty nine individual and institutional holders of subordinated debentures ("Bondholders") who filed a complaint in October 1994 as an adversary proceeding in defendant Intelogic Trace, Inc.'s ("Intelogic's") first bankruptcy proceeding in the United States Bankruptcy Court for the Western District Court of Texas ("bankruptcy court"). The Bondholders alleged causes of action against

Intelogic and eight former members of Intelogic's board of directors ("individual defendants") for breach of contract, negligence, common law fraud, and state and federal securities fraud.

The complaint was amended once before any response was filed in order to add an additional plaintiff and to correct the number of bonds purchased by one of the Bondholders. The complaint has never been substantively amended.

The bankruptcy court dismissed the complaint without leave to amend in April 1995 for failure to state a claim pursuant to Rule 7012 of the Federal Rules of Bankruptcy Procedure ("FRBP") and Rule 12(b)(6) of the Federal Rules of Civil Procedure ("FRCP"), and for failure to plead fraud with particularity pursuant to FRBP 7009 and FRCP 9(b). The Bondholders appealed the

dismissal to the United States District Court, Western District of Texas, San Antonio Division ("district court"). The district court affirmed the bankruptcy court's dismissal of the complaint without leave to amend in October 1997.

The Bondholders appealed the district court's ruling to the United States Court of Appeals for the Fifth Circuit ("Fifth Circuit"). In February 1999, a panel of the Fifth Circuit (Circuit Judges Higginbotham, Benavides, and Dennis) affirmed the district court's decision with respect to the negligence, common law fraud, and securities fraud causes of action on the basis that they were barred by applicable statutes of limitations. The panel reversed the district court's decision with respect to the breach of

contract claim, ruling that the Bondholders could amend their complaint to include a breach of contract claim against Intelogic only, but not the individual defendants. The panel held that the Bondholders had failed to provide any theory as to how the individual defendants could be personally liable for causing Intelogic to breach its contractual obligation with the Bondholders under the indenture agreement.

The Fifth Circuit ordered the matter remanded to the bankruptcy court, rather than the district court, for further proceedings.

2. FACTS MATERIAL TO CONSIDERATION OF THE QUESTIONS PRESENTED.

A. Introduction.

This case involves the looting and destruction of two publicly-held

companies, Intelogic and Datapoint Corporation ("Datapoint"), during the takeover mania of the 1980s. After driving the companies into insolvency, the individual defendants seek to escape all liability behind standard "no recourse" exculpatory language contained in the bond debenture.

The individual defendants, lead by a veteran corporate raider, defendant Asher B. Edelman ("Edelman"), took over both companies, wasted their assets on unsuccessful stock speculation and arbitrage activities, used Intelogic as a shell to conduct a fraudulent $100 million bond offering, and wasted those bond proceeds on still more unsuccessful stock speculation. After both companies were in shambles, they simply walked away, defaulting on the debenture's interest obligations and leaving the

Bondholders with losses exceeding $5.1 million.

Before walking away, however, Edelman and the individual defendants ran Intelogic through bankruptcy twice in a seven month period in order to insulate themselves from their misdeeds, profited from the sale of Intelogic securities by manipulating the market, awarded themselves generous severance packages, and gave themselves broad releases from all liability. They also made critical misrepresentations to the bankruptcy court in furtherance of this scheme, leading to Intelogic's eventual collapse and liquidation and to the appointment of an Examiner in Intelogic's second bankruptcy proceeding.

The lower courts' refusal to allow the Bondholders to amend their

complaint even once to allege these newly discovered, devastating facts was such a departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's supervisory power.

B. The Individual Defendants' Takeover And Destruction Of Datapoint And Intelogic.

In 1985 Edelman took over Datapoint, a publicly-traded computer manufacturer, through a hostile proxy contest. After causing Datapoint to reimburse him $1.5 million for expenses incurred in the takeover, Edelman installed himself and four of the other individual defendants (Clark R. Mandigo, Dwight D. Sutherland, Daniel R. Kail, and Leon Botstein) onto Datapoint's board of directors. All four of these individuals had participated with

Edelman in other takeover groups or sat with him on the boards of entities he controlled.

In return, Edelman rewarded them handsomely. For example, Botstein was president and co-trustee with Edelman of Bard College in New York. Between 1986 and 1989, Edelman contributed $1.5 million to Bard College. The individual defendants were beholden to Edelman and did his bidding.

Having depleted Datapoint, and in need of additional money to fund Edelman's arbitrage activities, the individual defendants took Intelogic, a Datapoint service division, and spun it off as an independent, publicly-traded company. Edelman then installed Mandigo, Sutherland, Kail, and Botstein onto Intelogic's board as well. He also brought onto Intelogic's board the

individual defendants Burton Lehman (Edelman's lawyer and business associate), Michael D. Schultz (Edelman's tax attorney, personal friend, and skiing buddy), and Henry G. Cisneros. As with Datapoint, Intelogic's board was packed with Edelman's cronies and hand-picked business associates.

To fund Edelman's need to engage in stock speculation and arbitrage, the individual defendants caused Intelogic to conduct a public debt offering of $100 million in July 1986. The bond proceeds were purportedly to be used to shore up Intelogic's shrinking revenue base by expanding its computer service business. The debenture contained standard exculpatory language:

"No Recourse Against Others.

> No past, present or future director, officer, employee, shareholder or incorporator, as such, of the Company or any successor shall have any liability for any obligations of the Company under the Debentures or the Indenture or for any claim based on, in respect of or by reason of, such obligations or their creation. Each Debentureholder by accepting a Debenture waives and releases all such liability. The waiver and release are part of the consideration for the issue of the Debentures."

This language was incorporated into the indenture agreement. The Bondholders purchased their bonds in the aftermarket between 1990 and 1994.

C. Edelman Is Given Carte Blanche With Respect To The Bond Proceeds.

Edelman was given complete, unfettered control over $60 million of the bond proceeds. With the approval of the individual defendants, he proceeded to squander all of it -- not on

expanding Intelogic, but on wildly unsuccessful arbitrage activities. He acquired British department stores and waged disastrous proxy battles. The funds were used by him as a personal arbitrage "slush fund." Although Intelogic was sliding into bankruptcy, the individual defendants admitted that they wanted "no role" in how the bond proceeds were spent. They did not require Edelman to get board approval before he invested the funds. He did not have to advise the board what he did with the funds. For his efforts, Edelman was allowed to keep 25% of any gains realized.

When a disgruntled shareholder complained about this waste, the individual defendants appointed themselves to a special committee to investigate their alleged wrongdoing.

After a four month "investigation," they concluded in June 1990 that they had done nothing wrong. The shareholder sued Intelogic, he was paid $2.4 million by Intelogic's D&O insurance carrier, and Intelogic and the individual defendants were released from all liability. Meanwhile, the waste of the bond proceeds continued unabated.

In November 1993, Intelogic was fast approaching insolvency. Drawing on experience, Edelman took immediate steps to maximize his "take" from Intelogic before it collapsed. He also took deliberate steps to insulate himself and the other individual defendants from all liability for their actions.

First, in November 1993, Edelman and other corporate insiders artificially inflated the market price

of Intelogic stock by issuing false press releases about a corporate contract. They then sold their personal holdings into this manipulated market at a large profit.

Shortly after selling his stock, Edelman began negotiating with Intelogic's creditors to give himself a generous severance package. For his performance as an Intelogic officer and director, he gave himself a $360,000 payout -- an amount equal to one year's net earnings for Intelogic. Edelman gave all of the individual defendants broad, general releases.

When Intelogic failed to make the interest payment due in July 1994, Edelman and the individual defendants had their plan in place. Three weeks later, in August 1994, Intelogic filed a prepackaged petition,

plan of reorganization, and disclosure statement. The plan of reorganization provided that the Bondholders would exchange their debt for equity in the reorganized company. At the confirmation hearing, Intelogic misrepresented the projected cash flow for the reorganized company in order to get the plan of reorganization confirmed. Customer contracts that were to supply critical funds for the reorganized debtor simply did not exist -- although sworn testimony to the contrary was presented to the bankruptcy court. It was critical, however, that the plan be confirmed so that Edelman and his cronies would obtain their releases.

Not surprisingly, the reorganized company failed almost immediately. In March 1995, four months

after its plan of reorganization was confirmed, Intelogic went bankrupt again. Its assets were liquidated one month later. The Bondholders, who had been issued stock in the reorganized company, saw their investment rendered worthless.

An Examiner was appointed by the bankruptcy court in the second bankruptcy proceeding. In his Report dated September 1995, the Examiner found that Intelogic had never in its entire existence met any of its projections. This was because, according to the Examiner, Intelogic's financial reporting system was hopelessly outdated, inherently unreliable, and incapable of producing reliable accounting and financial information.

As can be seen, the misrepresentations and material

omissions continued up to the day Intelogic commenced its first bankruptcy proceeding. The Bondholders were not, however, allowed to amend their complaint a single time to include these newly discovered facts so as to state causes of action for negligence, common law fraud, and securities fraud that would not be time barred.

D. Basis For Federal Jurisdiction In The Court Of First Instance.

The bankruptcy court had jurisdiction based upon 28 U.S.C. 1334(a), (b), and (c)(2) in that this matter arose under Title 11 of the United States Code or is a civil action related to Title 11 (establishment of debts of a bankruptcy debtor). Certain claims are founded upon the federal securities laws, 15 U.S.C. 78j(b), over which the federal courts have

jurisdiction. 15 U.S.C. 1337. In addition, certain claims are founded upon state law or are against non-debtor parties, over which the bankruptcy court had supplemental jurisdiction. 28 U.S.C. 1367.

## ARGUMENT

### 1. "NO RECOURSE" EXCULPATORY LANGUAGE CONTAINED IN A CORPORATE DEBENTURE IS NOT AN ABSOLUTE BAR TO HOLDING CORPORATE OFFICERS AND DIRECTORS LIABLE FOR ACTS OF AFFIRMATIVE NEGLIGENCE AND FRAUD THAT CAUSE A CORPORATION TO BREACH ITS CONTRACTUAL OBLIGATION TO PAY INTEREST UNDER THE DEBENTURE.

### A. The Individual Defendants Can Be Held Individually Liable For Intelogic's Breach Of The Debenture.

The Fifth Circuit incorrectly held that the Bondholders had "failed to provide any theory explaining how the Directors could nonetheless be liable

for Intelogic's nonpayment of its interest obligations under the debenture (emphasis added)." The Fifth Circuit limited its reversal, therefore, to permit a claim "against Intelogic, and not the Directors."

The Fifth Circuit's ruling is such an extreme departure from uncontroverted and controlling legal authority that it calls for an exercise of this Court's supervisory power.

The indenture agreement governs the relationship between the Bondholders and Intelogic. Broad v. Rockwell International Corp., 642 F.2d 929, 940-941 (5th Cir.)(en banc)(same), cert. denied, 454 U.S. 965 (1981). Section 11.09 of the indenture agreement provides that New York law governs the indenture and the securities issued thereunder:

> "Section 11.09. Governing Law. The laws of the State of New York shall govern this Indenture and the Securities without regard to principles of conflicts of law."

The relationship between the Bondholders and Intelogic, therefore, is governed by New York law.

As the Bondholders argued to the bankruptcy court, the district court, and the Fifth Circuit, the law in New York is that the individual defendants can be held personally liable for Intelogic's breach of the indenture if (1) they did not act in good faith and (2) their independent tortious acts caused Intelogic to miss the interest payment. Robbins v. Panitz, 475 N.Y.S.2d 274, 275 (1984); Murtha v. Yonkers Child Care Ass'n, Inc., 411 N.Y.S.2d 219, 220 (1978).

As the court stated in Murtha:

> "[A] corporate officer who is charged with inducing the breach of a contract between the corporation and a third party is immune from liability if it appears that he is acting in good faith as an officer...[and did not commit] independent torts or predatory acts directed at another (emphasis added)." 411 N.Y.S.2d at 220, quoting Buckley v. 112 Cent. Park South, 285 App. Div. 331, 334, 136 N.Y.S.2d 233, 236.

Even ignoring the indenture agreement's choice of law provision, the law is the same in Texas, which was brought to the Fifth Circuit's attention:

> "It has been held that an officer or director may not be held liable in damages for inducing the corporation to violate a contractual obligation, provided that the officer or director acts in good faith and believes that what he does is for the best interests of the corporation (emphasis added)." Maxey v. Citizens National Bank of Lubbock, 507 S.W.2d 722, 726 (1974).

The Fifth Circuit was plainly wrong, therefore, when it stated that the Bondholders "failed to provide any theory" for the individual defendants' personal liability for Intelogic's breach of the indenture agreement. It ignored black letter law of New York and Texas in this regard. More importantly, it is indisputable that the Bondholders alleged facts in their complaint (or could allege if given leave to amend) showing that Edelman and the individual defendants failed to act in good faith and committed independent torts with respect to the Bondholders.

The Fifth Circuit should have permitted the Bondholders to amend their complaint to include a claim against the individual defendants, as well as Intelogic. Its refusal to do so was contrary to well established precedent

and such an extreme departure from usual judicial proceedings that this Court's supervisory power should be exercised.

B. The Debenture's "No Recourse" Exculpatory Language Does Not Insulate The Individual Defendants From Their Acts Of Affirmative Negligence And Fraud.

The Fifth Circuit incorrectly held that the "no recourse" exculpatory language contained in the debenture is an absolute bar to the individual defendants being held personally liable for causing Intelogic to breach the indenture agreement:

> "The Indenture incorporates language from the debenture that limits the liability of past or present directors for any obligations of Intelogic under the Indenture or debenture. The Bondholders have failed to provide any theory explaining how the Directors could nonetheless be liable for Intelogic's nonpayment of its interest obligations under the

indenture."

Once again, the Fifth Circuit ignored the law in New York that an exculpatory clause in a contract will not be enforced in instances of bad faith or intentionl misconduct:

> "It has long been held that exculpatory clauses in a contract will not be enforced where the contractee has acted in bad faith, or otherwise engaged in willful, malicious or grossly negligent conduct during the performance of the contract. (Citations omitted.)" A.H.A. General Const. v. Housing Authority, 661 N.Y.S.2d 213, 215 (A.D. 1 Dept. 1997).

The Bondholders raised this point repeatedly in the Fifth Circuit. As the Bondholders argued in their suggestion for en banc rehearing:

> "The 'no recourse' language is meant to protect the directors only in situations where, due to circumstances beyond their control, the corporation is unable to meet its obligations under the indenture. In that

> situation, a corporate obligation should not be transferred to individuals. But where, as here, the directors' independent torts and bad faith directly caused the corporations' breach of the indenture, they cannot escape liability by attempting to contract it away. Murtha, supra; Maxey, supra."

The Fifth Circuit was simply wrong, therefore, when it stated that the Bondholders did not provide "any theory" for holding the individual defendants personally liable.

Any ambiguities in an exculpatory clause will be construed against the drafter, in this case Intelogic and the individual defendants. Uribe v. Merchants Bank of New York, 670 N.Y.S.2d 393, 396 (1998). The reasonable expectations and purposes of the parties to such contracts are "the guideposts to determine intent." Id. Exculpatory clauses will not be enforced

when, "in contravention of acceptable notions of morality, the misconduct for which it would grant immunity smacks of intentional wrongdoing." A.H.S. General Const., supra, 661 N.Y.S.2d at 215-216.

It is simply not reasonable to conclude that the Bondholders expected that the "no recourse" provision would relieve the individual defendants of responsibility for their intentional and tortious acts.

The Fifth Circuit's ruling raises extremely troubling policy issues. The individual defendants' wrongful conduct cannot, and was not intended to, be insulated by generic "no recourse" language. To do so is tantamount to declaring open season on bondholders and other corporate creditors. Officers and directors will use exculpatory language as carte

blanche to work their misconduct without accountability.

This Court must exercise its supervisory power and reverse the Fifth Circuit's clearly incorrect ruling.

2. THE BONDHOLDERS' CLAIMS ARE NOT BARRED BY APPLICABLE STATUTES OF LIMITATIONS.

The bankruptcy court and distict court incorrectly held, which holding was affirmed by the Fifth Circuit, that because the last specific act alleged by the Bondholders in their complaint occurred in 1990, that was the date when all applicable statutes of limitations started to run. All three lower courts completely ignored the argument presented by the Bondholders that they had (1) discovered new facts (2) after their complaint was filed. These newly discovered facts would bring

their claims for negligence and fraud within the statutes of limitations.

There is no dispute: (1) that the facts that could be included in an amended complaint were not (and could not have been) known at the time the original complaint was filed; or (2) that these newly discovered facts demonstrate a pattern of deception and omission that continued up to the date that Intelogic filed for bankruptcy. These newly discovered, critical facts surfaced after Intelogic filed its first bankruptcy petition in August 1994 and after the Examiner's report was issued in September 1995:

- Intelogic did not disclose that it had never in its entire existence met any of its projections;

- Intelogic did not disclose that it was incapable of producing reliable

accounting and financial information;

- Intelogic did not disclose that Edelman and other corporate insiders were trading Intelogic securities on the basis of inside information in anticipation of Intelogic's bankruptcy; and

- Intelogic did not disclose that Edelman was negotiating to take Intelogic into bankruptcy even while its bonds were trading on the open market.

These facts showed <u>continuing</u> misrepresentations and omissions by Intelogic and the individual defendants during the period 1990 through 1994 -- the period when the Bondholders purchased their bonds.

The Fifth Circuit did not consider or even acknowledge these newly discovered facts when holding that the Bondholders' claims were time barred.

This rulings was such an extreme departure from this Court's clearly enunciated standard -- that it appear beyond doubt that plaintiff can prove no set of facts in support of his claim which would entitle him to relief (Conley v. Gibson, 355 U.S. 41, 45-46 (1957)) -- that this Court must intervene and reverse the Fifth Circuit's clearly erroneous ruling.

**CONCLUSION**

In light of the foregoing, it is respectfully requested that petitioners' petition for a writ of certiorari be granted.

Dated: June 27, 1999

James A. Shalvoy
Counsel of Record
for Petitioners

# APPENDIX

[FILED April 4, 1995]
U.S. BANKRUPTCY COURT
BY _____ DEPUTY

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

| | |
|---|---|
| In Re: | § CHAPTER 11 |
| | § |
| INTELOGIC TRACE, INC., | § Case No. |
| | §94-52172C |
| Debtor. | § |
| | § |
| | § |
| Robert Sachs, NIBCO Nevada Inc., Karen Sachs, Claudia Sachs, Howard Yonet, Joseph Corda, Tomas Corda, Elizabeth J. Sampson & Assoc., Yony Properties Inc., Henry Yonet, Paul Yonet, Larry Wayne, Anne Wayne, Noam Schwartz, Marion Blackburn, Lois Esformes, Mary Ann McCain, Stan Cohen, Carol Seiden, Sachs Living Trust, Herbert H. Eveloff, M.D., Peter Kaltman, NEO Construction Inc., Joseph Fisch, Herbert H. Eveloff, M.D. IRA, Faye Eveloff, Gary Austin, L.F.I. Retirement Trust, Kay F. Gerhard, | § |
| | § |
| Plaintiffs, | § ADVERSARY |
| | §NO.94-5136C |
| V. | § |
| | § |

| | |
|---|---|
| Intelogic Trace, Inc., Asher B. Edelman, Clark R. Mandigo, Leon Botstein, Henry G. Cisneros, Daniel R. Kail, Burton Lehman, Michael D. Schultz, Dwight D. Sutherland, and Does 1 Through 20, Inclusive, | § |
| Defendants. | § |

**ORDER DISMISSING IN PART THE FIRST AMENDED COMPLAINT**

The Court, having considered the First Amended Complaint filed by the Plaintiffs, Defendants' Motion to Dismiss the First Amended Complaint (the "Motion"), the Memorandum of Law in Support of Defendants' Motion to Dismiss the First Amended Complaint (with Exhibits); the Response and Memorandum of Law in Opposition to Defendants' Motion to Dismiss First Amended Complaint and the Reply Memorandum of Law in Support of Defendants' Motion to Dismiss the First

Amended Complaint and the arguments of counsel, hereby holds, based upon its determination of facts and conclusions of law and as stated in open Court that:

A. Plaintiff Joseph Fisch has requested, that this Court has Ordered, that he be dismissed from this lawsuit without prejudice.

B. Plaintiffs have voluntarily dismissed their fifth cause of action alleging a violation of Section 17(a) of the Securities Act.

C. Plaintiffs have failed to plead the existence of any contract between any of the Defendants and the Plaintiffs for which relief may be granted, with respect to the first cause of action in the First Amended Complaint, pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure and Rule 7012 of the Federal

Rules of Bankruptcy Procedure.

D. Plaintiffs have failed to allege fraud with particularity and/or to allege scienter with respect to the second and sixth causes of action in the First Amended Complaint pursuant to Rule 9(b) of the Federal Rules of Civil Procedure and Rule 1009 of the Federal Rules of Bankruptcy Procedure.

E. Plaintiffs have failed to allege a statutory or common law duty between any of the Defendants and the Plaintiffs for which relief may be granted with respect to the third cause of action in the First Amended Complaint pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure and Rule 7012 of the Federal Rules of Bankruptcy Procedure.

F. All causes of action, save and except only the fourth cause of action

asserting a claim pursuant to Tex. Rev. C. Ann. 581-33, the Texas Blue Sky Law, in the First Amended Complaint are barred by applicable statutes of limitation, including, without limitation the Texas Statute of Limitations, Tex. Civ. Prac. & Rem. Code Ann. §16.004(a).

G. The Court reserves ruling on the fourth cause of action, pending submission of briefs which will be due on or before March 11, 1995.

NOW, THEREFORE, based upon the determination of facts and conclusions of law set forth above, and pursuant to Tex. Civ. Proc. & Rem. Code Ann. §16.004(A), Rules 9(b) and 12 (b)(6) of the Federal Rules of Civil Procedure and Rules 7009 and 7012 of the Federal Rules of Bankruptcy Procedure.

It is hereby ORDERED that Joseph

Fisch be and hereby is dismissed from this action without prejudice.

It is further ORDERED that the Motion is granted in all respect, SAVE AND EXCEPT only with regard to the fourth cause of action.

It is further ORDERED that first, second, third, fifth, and sixth causes of action in the First Amended Complaint filed by Plaintiffs, as defined in the Motion, are hereby dismissed without prejudice.

SIGNED this 3 day of March, 1995.

S/
LEIF M. CLARK
UNITED STATES BANKRUPTCY JUDGE

[FILED AUG 11, 1995]
U.S. BANKRUPTCY COURT
BY _____ DEPUTY

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

| | | |
|---|---|---|
| In re | ) | Bankruptcy |
| | ) | Case No. |
| INTELOGIC TRACE, INC. | ) | 94-552172-C |
| | ) | Chapter 11 |
| Debtor | ) | |
| | ) | |
| ROBERT SACHS, ET AL. | ) | |
| | ) | |
| Plaintiffs | ) | Adv. No. |
| | ) | 94-5136-C |
| v. | ) | |
| | ) | |
| INTELOGIC TRACE, ET AL. | ) | |
| | ) | |
| Defendants | ) | |

**ORDER GRANTING MOTION TO DISMISS FOR FAILURE TO STATE A CLAIM**

Defendants filed a motion to dismiss for failure to state a claim. The court granted the motion with respect to all causes of action, save and except Plaintiffs' state blue sky cause of action

under Texas' Blue Sky laws. This decision disposes of that remaining cause of action.

**Factual Background**

Plaintiffs, in the adversary proceeding, "are or were," holders of subordinated debenture issued by Intelogic Trace on July 22, 1986 through a public offering. Defendants are Intelogic Trace, Inc. and a number of its former officers or directors. Intelogic Trace is a New York corporation which had its principle place of business in San Antonio, Texas. On August 5, 1994, Intelogic Trace filed for chapter 11 relief.[1]

The complaint also names certain other individuals as Defendants who seem to be

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[1] A plan was confirmed in this case, but the debtor returned to bankruptcy three months later and its assets were in short order liquidated.

either former officers or former directors of Intelogic Trace. Among these individual defendants are Asher B. Edelman, Clark R. Mandigo, Dwight D. Sutherland, Daniel R. Kail, Burton Lehman, Michael E. Schultz, Leon Bolstein, Henry G. Cisneros. Apparently Edelman and Mandigo were officers of Intelogic Trace, while the remainder were simply directors. All of the Defendants, with the exception of Henry G. Cisneros, are alleged to have been directors during the entire period concerning this action. Henry G. Cisneros is alleged to have been a director during

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"a part of 1989," only.[2]

In March 1985, Edelman and others acquired voting control of Datapoint Corporation in a hostile proxy contest. In June 1985, Datapoint formed Intelogic Trace as a subsidiary for the purpose of operating Datapoint's domestic computer servicing business. In July 1985, Intelogic Trace became a separate, publicly traded company. Edelman, Kail, Mandigo, and Sutherland allegedly served

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[2]One thing which must be kept in mind concerning this case is that there are really two different "groups" of defendants. The first group is Intelogic Trace, so that it is really not a group, but an individual defendant. The second group is the individual board of directors or officers. The plaintiffs confuse this and simply refer to the two groups as "defendants." Thus, there allegations are anything but specific as to the individual officers or directors, which leads to confusion.

as directors of both Datapoint and Intelogic Trace, after Intelogic Trace became an independent corporation.

The debentures in question here were sold in July 1986. The total amount of debentures sold was valued at $100 million. Plaintiffs allege that the debentures were sold pursuant to a prospectus dated July 22, 1986. An Indenture Agreement was entered into between Intelogic Trace and the debenture holders, though the exact date of its execution is unknown at this time[3]

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[3]Another somewhat confusing aspect of the facts, as they have been plead by the plaintiffs is the lack of any information concerning an "Indenture Trustee." Generally, when an indenture agreement is entered into between a corporation and individual debenture holders, a indenture trustee is appointed. There are individual references in the pleadings which cause the belief that a trustee was

(continued...)

Based on the foregoing uncontroverted facts, then, each of the plaintiffs either purchased debentures from Intelogic Trace outside the five year statute of limitations for bringing this sort of action, or they purchased the debentures within the five years, but in the secondary market.

**Discussion**

*1. Standard for 12(b)(6) Motion*

In the Fifth Circuit, two primary principles guide review of a complaint sought to be dismissed under rule 12(b)(6). *Kaiser Aluminum, Etc. v. Avandale Shipyards, Inc.*, 677 F.2d 1045, 1050 (5th Cir. 1982) (citing 5A WRIGHT &

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[3](...continued)appointed, but there was no specific references concerning identity, responsibility, or position in this lawsuit.

MILLER, FEDERAL PRACTICE AND PROCEDURE: CIVIL § 1357 at 598 (1969). First, a court must accept as true all well pleaded facts in the complaint, and the complaint should be liberally construed in favor of the plaintiff. Id. (citing *Miller v. Stanmore*, 636 F.2d 986, 988 (5th Cir. 1981)); *see also Bruce v. First Fed. Sav.& Loan Ass'n of Conroe*, 837 F.2d 712 (5th Cir. 1988). Second, a complaint should not be dismissed for failure to state a claim unless it appears beyond a doubt that the plaintiff can prove no set of facts in support of his claim that would entitle him to relief. *Id.; see also Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). The question under rule 12(b)(6) is not whether the plaintiff has plead facts sufficient to support his stated claim,

but whether he would be entitled to recover under "any set of facts." *Quinonez v. Nat. Ass'n of Securities Dealers, Inc.*, 540 F.2d 824 (5th Cir. 1976).

A court need not accept as true conclusary allegations in the complaint. *Kaiser,* 677 F.2d at 1050 (citing *Associated Builders, Inc. v. Alabama Power Company,* 505 F.2d 97, 100 (5th Cir. 1974)). Further, a complaint that shows relief to be barred by an affirmative defense, such as the statue of limitations, may be dismissed for failure to state a claim. *Id.* But, as a general rule, to be dispositive under rule 12(b)(6) a statute of limitation defense must appear on *the face of the complaint. United Transportation Union v. Florida East Coast Railway Company,*

586 F.2d 520, 527 (5th Cir. 1978). If the facts as plead will not admit of any other set of facts, and those facts themselves do not state claim, relief is of course appropriate.

*2. Texas Blue Sky Law*

Plaintiffs allege that Defendants violated article 581-33 of the Texas Blue Sky Laws. The Plaintiffs allege that the Defendants sold securities to Plaintiffs by means of untrue statements of material fact or by omitting to state material facts concerning the sale of the debenture bonds and the use of proceeds from that sale. Article 581-33 provides:

> A person who offers or sells a security (whether or not the security or transaction is exempt under Section 5 or 6 of this Act) by means of an untrue statement of material fact or omission to state a material fact necessary in order

> to make the statements made in light of the circumstances under which they are made, not misleading is liable to the person buying the security from him, ... for damages.

TEX. REV. C. STAT. ANN., art. 581-33(H) (Vernon Supp. 1995).

Article 581-33 is governed by a two tiered statute of limitations. A claim may be brought within three years of the discovery of the violation, but in no case can the claim be brought after five years have elapsed from the time of purchase. *See Williams v. Khalaf,* 802 S.W.2d 651, 655 (Tex. 1990); TEX. REV. C. STAT. ANN. 581-33(H) (Vernon Supp. 1995). The latter provision operates as a statute of repose.

The Plaintiffs allege that their complaint does not show when the bonds where purchased. From this, Plaintiffs argue that their claim cannot be dismissed because facts establishing the existence

of the statute of limitations defense do not appear upon the face of the complaint. Plaintiffs do however affirmatively state that they did not buy the bonds through the initial offering, and that they purchased the bonds within the last five years. These statements are fatal to Plaintiffs' remonstrations. If the Plaintiffs bought bonds within the last five years, then they cannot have stated a claim under Texas securities law because article 581-33 only applies to initial offerings and does not apply to secondary transactions. *See Reed v. Prudential Securities Incorporated,* No. CIV A. H-93-819 1995 WL 54100 (S.D. Tex. 1995).

*The Reed* court noted that article 581-33 of the Texas Securities Act was nearly identical to and actually modeled after

section 12(2) of the Federal Securities Act. Id. at *8. (citing comment to article 581-33). Cases interpreting the Texas Securities Act rely upon decisions under the Federal Act, based upon these similarities. Id. (citing *Haralson v. E.F. Hutton Group,* Inc., 919 F.2d 1014, 1031 n. 9 (5th Cir. 1990); *MBank Fort Worth, N.A. v. Trans Meridian,* Inc., 820 F.2d 716, 725 (5th Cir. 1987); *Anheuser-Busch v. Summit Coffee Co.,* 858 S.W.2d 928,941 (Tex. App. 1993). These notations led the court to find that the Texas Securities Act should be construed the same as the Federal statute, and that like the Federal Act, the Texas Act should be construed not to apply to secondary market transactions. *Id.*

The *Reed* court's analysis is sound.

First, section 12(2) does indeed not apply to secondary market transactions. *Gustarson v. Alloyd Company, Inc.*, ___ U.S. ____, 115 S.Ct. 1061, 1073-74, ___ L.Ed.2d ___(1995) (section 12(2) of the Federal Securities Act only applied to initial offerings and not secondary market transactions).

*3. Application to Facts*

An application of the *Reed* holding to the present case puts the Plaintiffs in a rather precarious position. One might say that they find themselves between a rock and a hard place. On the one hand, if the Plaintiffs did not purchase their bonds at the initial offering then their claims should be dismissed, because the Texas statute only applies to primary or initial offerings. On the other hand, if the

Plaintiffs bought their bonds at the initial offering, then their claims are, of necessity, barred by the statute of limitations. Under article 581-33(H), any claim based upon the Texas Securities Law must be brought within five years of the sale. The initial sale took place in 1986. The present cause of action was filed eight years later. Thus, if the Plaintiffs purchased their bonds at the initial sale, the cause of action would be barred.

The Plaintiffs do not allege that they purchased their bonds at the initial sale. Less specifically in their initial brief, the Plaintiffs allege that they purchased the bonds within the last five years. In their latest brief, the Plaintiffs allege to have all bought their bonds between 1992 to 1994. Under the facts as plead, they are barred under *Reed*. But if, to

evade *Reed*, Plaintiffs plead they purchased at an initial offering, they are barred by limitations. Either way, Plaintiffs lose.

**Conclusion**

For the foregoing reasons, the court finds that the Plaintiffs have failed to state a cause of action for which relief may be granted. The remainder of their complaint is dismissed.

So **ORDERED**.

**SIGNED** this 10 day of August, 1995.

S/

**LEIF M. CLARK**
U.S. Bankruptcy Judge

[FILED OCT 17 1997]
CLERK, U.S. DISTRICT COURT
WESTERN DISTRICT OF TEXAS
BY_____DEPUTY CLERK

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

| | |
|---|---|
| In re: | )Bankruptcy No. |
| INTELOGIC TRACE, INC. | )94-552172-C |
| | ) |
| Debtor | ) |
| | ) |
| | ) |
| ROBERT SACHS, et al. | ) |
| | ) Adversary |
| Appellants, | ) No. |
| | ) 94-5136-C |
| v. | ) |
| | )CIVIL ACTION |
| INTELOGIC TRACE, ET AL. | )NO. |
| | )SA-95-CA-1007 |
| Appellees. | ) |
| | ) |

**ORDER AFFIRMING BANKRUPTCY COURT'S RULING**

This is an appeal from the Bankruptcy Court's April 5, 1995 order dismissing Appellants' first amended complaint for failure to state a claim. Appellants are thirty individual and

institutional investors who held bonds issued by Debtor Intelogic Trace, Inc. (the "Bondholders"). Appellees are Intelogic Trace, Inc. and eight former members of its board of directors [1] (collectively, the "Corporate Defendants"). The Bondholders argue that the Bankruptcy Court erred in granting the Corporate Defendants' motion to dismiss their complaint for failure to state a claim, failure to plead fraud with particularity and failure to file within the statute of limitations. They further contend that the Bankruptcy Court improperly denied them leave to

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[1]These individuals are Asher B. Edelman, Clark R. Mandigo, Leon Botstein, Henry G. Cisneros, Daniel R. Kail, Burton Lehman, Michael D. Schultz and Dwight D. Sutherland (sometimes hereinafter referred to as the "Individual Defendants").

amend. This Court discerns no reversible error and affirms.

I. Procedural History.

The Bondholders commenced this adversary proceeding on October 4, 1994 by filing a "Complaint for Securities Fraud," and amending it shortly thereafter. Their "First Amended Complaint for Securities Fraud" consists of twenty-seven single-spaced pages. It begins with two sections, the first captioned "Background (Use of Intelogic Bond Funds to Make Edelman a Takeover Player)," and the second "Threatened Takeover of Datapoint and Misuse of Intelogic Funds." (R. Doc. 12 at 10, 14). These sections describe a series of events, from the creation of Intelogic Trace, Inc. as a subsidiary of the Datapoint Corporation, its subsequent

spinoff as a separate corporation, the company's issuance of $100 million of subordinated debentures ("the Bonds"), and its eventual filing of a voluntary petition for bankruptcy on August 5, 1994. In general, the Bondholders allege that Intelogic Trace, Inc., under the direction of former chairman of the board Asher B. Edelman, used the proceeds of the Bonds for unwise investments in companies totally unrelated to Intelogic's primary business of servicing computers or to purchase stock in Datapoint to avoid a proxy contest which might have resulted in Edelman's ouster as chairman of Datapoint's board of directors. Based on these allegations, the Bondholders plead six causes of action: (1) breach of contract, (2) intentional

misrepresentation (fraud), (3) negligence, (4) violation of Texas's Blue Sky laws, (5) violation of 15 U.S.C. §77q(a), and (6) securities fraud. In action irrelevant for the purposes of this appeal, the fourth and fifth claims were dismissed.

The Corporate Defendants moved to dismiss the amended complaint on November 21, 1994. They argued that (1) the Bondholders had failed to state claim for breach of contract because the prospectus describing the Bonds (the "Prospectus") was not a contract, the Individual Defendants could not be held liable for a breach by the corporation and the claim was barred by the statute of limitations, (2) the claim for fraud was barred by the statute of limitations and not plead with particularity, (3)

the negligence claim was also time-barred and failed to state a claim because the Corporate Defendants owed no duty to the Bondholders, (4) the securities fraud claim was time-barred, no scienter was plead and no term of the bond indenture agreement (the "Indenture") was violated. The Bondholders responded to the motion, denying that the complaint was defective for any of these reasons.

On February 23, 1995, the Bankruptcy Court held a hearing on the Corporate Defendants' motion to dismiss. Methodically, the Bankruptcy Court proceeded claim-by-claim, first to determine the factual allegations to support the essential elements of each claim, and second to consider whether the Corporate Defendants' arguments for

dismissal of the claim were well taken. Counsel for the Bondholders responses to the court's inquiries, described charitably, were less than focused. At the conclusion of the hearing, the Bankruptcy Court made the following observation:

> Well, we have a lot of different causes of action here. And I feel like it's been-You all ever been at a school yard around recess when the teacher is trying to gather up about 20 six and seven-year-olds, and they are all running around? And the kids sort of get it into their mind that it would be kind of fun to get caught. And you're running around trying to catch them, and they keep slipping away from your grasp, and its just really hard to gather them all up together because just when you've got one, another one comes running over here, and you let go of this one and try to grab that one and they quickly elude your grasp.
>
> That's what this feels like. This feels like as soon as you think you've got it nailed down, it slips out from under you.

(Tr. at 91-92.) Concluding that the Corporate Defendants' motion should be granted, the Bankruptcy Court went on to hold that leave to amend would be denied. The Bondholders now appeal.

## II. Issues.

### A. Standards of Review.

This Court may not set aside a Bankruptcy Court's factual findings unless clearly erroneous. Bankr. R. 8013. Its legal conclusions, however, are subject to de novo review. See Shurley v. Texas Commerce Bank-Austin, N.A. (In re Shurley), 115 F.3d 333, 336 (5th Cir. 1997); Davis v. Davis .(In re Davis), 105 F.3d 1017, 1019 (5th Cir. 1997). Since the primary question framed by this appeal is whether the Bankruptcy Court erred in dismissing the Bondholders' complaint, an issue of law,

the Court reviews the Bankruptcy Court's rulings on that question de novo. See Lowrey v. Texas A & M Univ. Sys., 117 F.3d 242, 246 (5th Cir. 1997)(motion to dismiss under Rule 12(b)(6) reviewed *de novo*); Lovelace v. Software Spectrum, Inc., 78 F.3d 1015, 1017 (5th Cir. 1996)(dismissal for failure to state claim and failure to plead fraud with particularity reviewed de *novo)*. On the other hand, denial of leave to amend, subject to certain limitations, is a matter in the trial court's discretion. Lowrey, 117 F.3d at 245. The Court therefore reviews that aspect of the Bankruptcy Court's ruling for an abuse of discretion.

It is well established that, for the purposes of a motion to dismiss under

Fed. R. Civ. P. 12(b)(6), all well-pleaded factual assertions must be taken as true, United States v. Gaubert, 499 U.S. 315, 327 (1991), and all allegations construed in the light most favorable to the pleader, Meadowbriar Home for Children, Inc. v. Gunn, 81 F.3d 521,529 (5th Cir. 1996). The same standards apply to dismissals for failure to plead fraud with particularity. See Lovelace, 78 F.3d at 1017. In considering such motions, the reviewing court is generally limited to the contents of the complaint and any attachments thereto. The court may, however, consider documents whose contents are alleged in the complaint and whose authenticity is not questioned but which are not physically attached to the complaint. See, e.g.,Wright v.

Associated Ins. Cos., 29 F.3d 1244, 1248 (7th Cir. 1994)(documents attached to motion to dismiss, referred to in pleadings and central to plaintiff's claim properly considered); Venture Assocs. Corp. v. Zenith Data Sys. Corp., 987 F.2d 429, 431 (7th Cir. 1993)(same); Watterson v. Page, 987 F.2d 1, 3 (1st Cir. 1993)(same); Sheppard v. Texas Dept. of Transp., 158 F.R.D. 592, 595-96 (E.D. Tex. 1994); Geren v. Quantum Chem. Corp., 832 F. Supp. 728, 734 n.4 (S.D.N.Y. 1993)(bond indenture, though not part of complaint, considered on motion to dismiss); UPIC v. Kinder-Care Learning Ctrs. Inc., 793 F. Supp. 448, 452 (S.D.N.Y. 1992)(same). The Court may also take judicial notice of any documents which are required to be and are actually filed with the

Securities Exchange Commission. See Lovelace, 78 F.3d at 1017-18. Consequently, in assessing whether the motion to dismiss is well-taken, the Court considers not only the First Amended Complaint, but the Prospectus and the Indenture.

Furthermore, the Court notes that, as to the breach of contract, fraudulent misrepresentation and negligence claims, the parties and the Bankruptcy Court have relied on both Texas and New York law, without any express analysis of the apparent choice of law issue. The Court assumes from the Corporate Defendants' analysis that they would assert that any conflict of law is a false one; therefore, choice of law is irrelevant. The Bondholders ignore the issue altogether, and the Bankruptcy Court's

order does not reflect its views. Nevertheless, this Court would have been aided in its analysis had the parties or the court below provided some explanation of whether choice of law is relevant in this case.

Choice of law in bankruptcy cases is not clear-cut. Some courts follow the general rule of Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487, 496 (1941), that federal courts, including those sitting in bankruptcy, should apply the choice of law rules of the state in which they sit. Others hold that the court may exercise its independent judgment to select the appropriate substantive law. See generally In re Morris, 30 F.3d 1578, 1581-82 (7th Cir. 1994)(citing cases following both approaches). Thus, either

Texas's choice of law rules apply, since it is the forum state, or the Court may select the appropriate substantive law without regard to Texas' choice of law principles.

Since neither party has made an issue of choice of law, however, this Court need not make an independent determination of it. See In re Stoecker, 5 F.3d 1022, 1029 (7th Cir. 1993). Furthermore, case law and commentary regarding bondholders' rights against issuing corporations and their directors is not extensive. Therefore, even were the Court to make this choice it would be forced to look to the law of other jurisdictions for guidance. To the extent a determination in necessary, however, the Court applies Texas law

unless otherwise noted.[2]

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[2]For the most part, under Texas' choice of law rules or this Court's independent judgment, all roads lead to Texas. Clearly, Texas law comes into play because Intelogic Trace, Inc. was a Texas corporation and the majority of the unlawful actions alleged in the complaint took place here. On the other hand, the Indenture provides that New York law governs it and the Bonds. (Indenture, ¶ 11.09).

Under most choice of law rules, the parties contractual agreement to forum will govern, at least as to contract-based claims. See Caton v. Leach Corp., 896 F.2d 939, 943 (5th Cir. 1990) Yet, as explained in further detail below, the Bondholders did not plead and could not plead a breach of Indenture; therefore, New York law would come into play only to the extent necessary to make that determination. With respect to the contract claim as premised on the Prospectus and the remaining common-law tort claims for fraudulent misrepresentation and negligence, under Texas's choice of law rules and this Court's independent judgment, Texas law applies, as it is the state having the most reasonable relationship to the parties and the controversy.

(continued ...)

B. Dismissal of Contract Claim.

In its April 4, 1995 order, the Bankruptcy Court dismissed the Bondholder's breach of contract claim for failure to plead the existence of any contract between themselves and the

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[2] (...continued) See Caton, 896 F.2d at 942 (5th Cir. 1990) contractual choice of law clause binding under Texas law only to extent chosen law has reasonable relation to parties and state and is not contrary to Texas law); Gutierrez v. Collins, 583 S.W.2d 312, 318 (Tex. 1979)(law applicable to tort claim determined by state with most significant relationship to controversy). Finally, Texas' statutes of limitation, as procedural in nature, govern. See Resolution Trust Corp. v. Northpark Joint Venture, 958 F.2d 1313, 1318 (5th Cir. 1992), cert. denied, 506 U.S. 1048 (1993); Ellis v. Great Southwestern Corp., 646 F.2d 1099, 1111-12 (5th Cir. Unit A 1981). See generally, Tennimon v. Bell Helicopter Textron, Inc., 823 F.2d 68, 71 n. 2 (5th Cir. 1987) where limitations procedural in nature, forum state's period applies).

Corporate Defendants and because the claim was barred by the statute of limitations. The Bondholders take issue with both of these conclusions. First, they contend that they plead a viable cause of action for breach of contract, either based on the Prospectus or on the Indenture. Second, they insist that any such claim would not be barred by the statute of limitations. This Court disagrees.

Construing the complaint liberally and in the Bondholders' favor, the breach of contract claim is plainly based on a breach of the Prospectus. In particular, the complaint quotes the "Use of Proceeds" section of the Prospectus, which provides that certain bond proceeds will be used to acquire other companies in computer maintenance

or related fields. (Id. ¶ 46.) The Bondholders then allege that the Corporate Defendants did not follow this directive, but instead used Bond proceeds to fund stock speculation, (id. ¶ 72), purchase a British merchandising company, (id. ¶ 73), and finance a "slush fund" to wage a proxy battle, (id. ¶ 74). Although the Bondholders continue to maintain that the Prospectus, "either directly or by incorporation or implication" constitutes a contract between them and the Corporate Defendants, (see Appellants' Op. Br. at 20), they offer no authority or analysis to support this contention. Therefore, the Court would be justified in considering this argument to have been abandoned. See United States v. Dunkel, 927 F.2d 955,

956 (7th Cir. 1991)(skeletal argument, which is nothing more than a mere assertion, doe not preserve claim on appeal, as "[j]udges are not like pigs, hunting for truffles buried in briefs").[3]

Nevertheless, the Bondholders' focus on the Prospectus as the premise of their contract claim is misplaced as a

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[3] Likewise, on appeal, the Bondholders fail to address their theory, if any, to support the Individual Defendants' liability for the various other claims alleged in the First Amended Complaint. As the Corporate Defendants point out, the Bonds, the Prospectus and the Indenture all contain language limiting the liability of past, present and future directors of Intelogic Trace, Inc. "for any claim based on, in respect of or by reason of such obligations [of the Company under the Debentures or the Indenture] or their creation." (R. Doc. 13c Indenture, Ex. a ¶ 16)(paragraph 16 of Debenture). For this reason, the Court finds that the Bankruptcy Court did not err in dismissing the claims against the Individual Defendants.

matter of law and as matter of fact. First, "[b]ondholders rights are a matter of contract, governed by the trust indenture and general principles of contract law." Leverso v. SouthTrust Bank of Al., N.A., 18 F.3d 1527, 1531 (11th Cir. 1994). The instrument defining the rights of the Bondholders is the Indenture, not the Prospectus. Broad v. Rockwell Int'l Corp., 642 F.2d 929, 941,948 n.21 (5th Cir. 1981), cert. denied, 454 U.S. 965 (1981); Geren v. Quantum Chem. Corp., 832 F. Supp. at 731 ("the relationship between [the corporation] and the Bondholders is governed by contract-the indenture for the Bonds"). Metropolitan Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1515-16 (S.D.N.Y. 1989)(focusing on language of indenture as source for

bondholders' rights). "[A]lthough the debts created by the debentures run directly from the issuer to the holders, the contractual rights conferred by the indenture run from the issuer to the trustee" for the bondholders' benefit. Broad, 642 F.2d at 941; see also 6A Fletcher Cyclopedia of the Law of Private Corporations § 2748 at 198 (1997). Thus, as a matter of law, the Prospectus does not provide a basis for the Bondholders' breach of contract claim.

Second, even were the Court to recognize the Prospectus as a source for the Bondholders' contractual rights, as factual matter, the express language of the "Use of Proceeds" provision upon which the Bondholders rely negates any obligation to limit application of the

Bond proceeds in the manner suggested.

That provision reads:

> The balance of the net proceeds will be added to general corporate funds to provide additional corporate liquidity and for possible future acquisitions. The Company currently expects that the primary purpose of any such acquisition financed with any portion of the proceeds will be to expand its maintenance services business or to enter into other service or related businesses. The Company continually reviews possible acquisitions but, at the present time, there are no negotiations, agreements or understandings respecting any such acquisitions and there can be no assurance that any such acquisitions will be made.

(R. Doc. 13, Ex. a at 6.) Thus, the Prospectus states only that the net proceeds of the Bonds (after redemption of certain notes and preferred stock) will be added to "general corporate funds" to provide for "additional corporate liquidity," and that future

acquisition of any service-related business was merely a possibility. A broader statement of the uses to which the Bond proceeds were to be applied could hardly be conceived. Consequently, the Bondholders' allegations, even taken as true, do not demonstrate a breach of the "Use of Proceeds" section of the Prospectus. Cf. Metropolitan Life Ins. Co., 716 F. Supp. at 1516 n. 20 (even looking beyond language of indenture, plaintiffs failed to show corporation's actions were prohibited).

The Court next turns to the Bondholders' eleventh-hour alternative argument: that "they can plead (and... will plead)" a breach of the Indenture. (Appellants' Op. Br. at 20.) First, neither the word "Indenture," nor any other reference to that document,

appears in the complaint. While the Court is obliged to give the complaint a liberal construction, it need not pull allegations out of thin air. See Campbell v. City. of San Antonio, 43 F.3d 973, 975 (5th Cir. 1995)(court is not required to "'conjure up unpled allegations or [contrive] elaborately arcane scripts to' save a complaint") (citation omitted); Beck v. Interstate Brands Corp., 953 F.2d 1275, 1276 (11th Cir. 1992)(although reviewing court must take complaint's allegations as true, it is not permitted "to read into the complaint facts that are not there.")

Second, as the Bankruptcy Court observed during the hearing on the motion to dismiss, permitting the Bondholders to replead to allege a breach of the Indenture would be futile.

As noted above, most indenture agreements, including the one at issue here, contain a "no action" clause that requires disgruntled bondholders who believe there has been a violation of the terms of the indenture to first present their complaint to the indenture trustee. (See R. Doc. 13, Ex. B §7.06.) Only if the trustee refuses to take action may the bondholders institute a claim against the issuer. Consequently, compliance with the procedures set forth in the no action clause is a condition precedent to a bondholder derivative suit. 6A Fletcher Cyclopedia of the Law of Private Corporations, supra at 201 ("it must be shown, as a condition precedent to the action, that the trustee has been requested to bring the action and that the trustee refused so

to do" ). The Bondholders have not plead, nor is there any indication they could plead, facts showing compliance with this requirement. See McMahan & Co. v. Wherehouse Enter., Inc., 859 F. Supp. 743,747-49 (S.D.N.Y. 1994), aff'd in pertinent part, 65 F.3d 1044 (2d Cir. 1995), cert. denied, 116 S. Ct. 1678 (1996).[4] For these reasons, the

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[4]On appeal, the Bondholders attempt to recast their breach of contract claim as one for failure to make the July 15, 1994 interest payment on the bonds. Although the Court acknowledges that such a claim may not be barred by the no-action clause, see In re Envirodyne Indus.. Inc., 174 B.R. 986, 992-96 (Bankr. N.D. Ill. 1994), the Court declines to reach this issue. First, the plain language of the complaint, construed with utmost liberality, cannot be interpreted as asserting such a claim. Compare UPIC & Co. v. Kinder-Care Learning Ctrs, Inc., 793 F. Supp. 448 (S.D.N.Y. 1992); In re Envirodvne Indus., Inc., 174 B.R. at 996 (Defendant bondholders' filing of involuntary

(continued...)

[4] (...continued)
petition against issuer characterized as action seeking payment of past-due interest).

The Bondholders steadfastly rely on the oft-quoted formula that a motion to dismiss may not be granted unless it is clear that the plaintiff cannot plead any set of facts sufficient to set forth a claim, such language does not require this Court to completely rewrite the complaint to assert an entirely new claim completely divorced from any facts or law set forth below. See Kansa Reinsurance Co., 20 F.3d 1362, 1366 (5th Cir. 1994) (Rule 12(b)(6) dismissal to be upheld when "'it appears that no relief could be granted under any set of facts that could be proved consistent with the allegations'") (emphasis added, citation omitted).

Second, the Bondholders failed to make this argument below. See Dorothy J. v. Little Rock School Dist., 7 F.3d 729, 734 (8th Cir. 1993) ("While complaints are to be liberally construed, 'an attempt to amend one's pleadings in an appellate brief comes too late.'") (citation omitted). Except for one passing reference during the hearing on the motion to dismiss, (see Tr. at 49) ("The contract wasn't breached until they missed the interest payment."), the Bondholders offered no argument to support this theory of their claim. Therefore, this Court declines to speculate on whether the failure to make

the Bankruptcy Court did not err in holding that the Bondholders had failed to state a claim for breach of contract, fraudulent misrepresentation or negligence due to the failure to comply with the no action clause.[5] See Feldbaum v. McCrory Corp., 1992 WL 119095 at *6 (Del. Ch. June 2, 1992).

Finally, the Bankruptcy Court did not err in holding that the breach of contract claim was barred by the statute of limitations. While the statute of

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[4](...continued) the interest payment had ripened into an event of default under the Indenture and, if so, whether such a claim is cognizable in an adversary proceeding or must be otherwise handled through the proof of claim or other bankruptcy mechanism.

[5]Failure to comply with these procedures is not a bar to the securities fraud claim, however. See id. at 750.

limitations defense must normally be affirmatively plead, where the allegations in a party's complaint show that a claim is time-barred, it may be considered on a motion to dismiss. See Kansa Reinsurance Co., 20 F.3d at 1366 (defense must appear on face of complaint); Hoover v. Langston Equip. Assocs., Inc., 958 F.2d 742, 744(6th Cir. 1992)(allegations of time material under Fed. R. Civ. P. 9(f); therefore, limitations defense may be raised where face of complaint indicates time-barred); EEOC v. Park Ridge Public Library, 856 F. Supp. 477, 480 (N.D. Ill. 1994); see generally 5A Charles A. Wright & Arthur R. Miller, Federal Practice & Procedure § 1357 at 350-51 (1990). In cases where it appears from the face of the complaint that a claim

is time-barred, the plaintiff has an affirmative burden to plead matters that would indicate why the limitations bar is not tolled or otherwise inapplicable. Hoover, 958 F.2d at 744-45 (plaintiff may not escape statute of limitations by saying nothing); EEOC v. Park Ridge Public Library., 856 F. Supp. at 480; cf. Garrett v. Commonwealth Mortgage Corp., 938 F.2d 591, 594 (5th Cir. 1991)(requiring plaintiff to plead secret agreement sufficient to surmount D'Oench Duhme defense apparent from face of complaint).

The parties agree that, under Texas law, such claims must be brought within four years of accrual. Williams v. Khalaf, 802 S.W.2d 651,653 (Tex. 1990); Kansa Reinsurance Co. v. Congressional Mortgage Corp., 20 F.3d 1362, 1369 (5th

Cir. 1994). A breach of contract claim accrues upon the date of the breach. Tel-Phonic Services, Inc. v. TBS Int'l. Inc., 975 F.2d 1134, 1143 (5th Cir. 1992). Here, the last event upon which the breach of contract claim, or any other claim for that matter, is premised occurred in June of 1990, when "a special committee concluded that the corporation would not institute litigation as demanded by the Intelogic shareholder" regarding the identical malfeasant acts alleged here. (Compl. ¶ 67.) Yet, the Bondholders' complaint was not filed until October of 1994, approximately four months past the four-year limitations period. The Bondholders failed to allege any facts to show why the prescriptive period has not run. Although they contended in the hearing

before the Bankruptcy Court that they did not purchase their Bonds in the secondary market until sometime between 1991 and 1994, that allegation is of little consequence. As noted above, their claim accrued on the date of the alleged breach, not on the date they purchased their Bonds. Therefore, their breach of contract claim, under any theory, is time-barred.[6]

C. Dismissal of Common Law Fraud Claim.

The Bondholders next argue that their intentional misrepresentation claim was not subject to dismissal. Though relying on all preceding allegations, the Bondholders attempt to narrow this claim by stating that "the

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[6]See also footnote 7, below.

representations in the Bond Prospectus regarding the use of proceeds from the sale of the Bonds were intentionally misrepresented and were materially false," (First Am. Compl. ¶ 77), that the Corporate Defendants should have known they were false, (id.) and that they intended that the Bondholders would rely on those misrepresentations, (id.) and that the Bondholders did, in fact, rely on those misrepresentations to their damage, (id.). The Bankruptcy Court dismissed this claim for failure to plead fraud with particularity, failure to allege scienter and failure to bring the claim within the statute of limitations. (R. Doc. 29 at 2-3.) This Court agrees with these conclusions and further concludes that the allegations fail to state a colorable claim for

fraudulent misrepresentation.

To state a claim for fraudulent misrepresentation under Texas law, a party must allege "(1) that a material misrepresentation was made; (2) that it was false; (3) that the speaker knew it was false when made or that the speaker made it recklessly without any knowledge of the truth and as a positive assertion; (4) that he made it with the intention it be acted upon by the other parties; (5) that the party acted in reliance upon it; and (6) that the party was damaged." Swanson v. Schlumberger Tech. Corp., 895 S.W.2d 719, 729 (Tex. App.-Texarkana 1994, writ granted); see also Hoechst Celanese Corp.. v. Arthur Bros., 882 S.W.2d 917, 923 (Tex. App.--Corpus Christi 1994, writ denied); Beijing Metals & Minerals Import/Export

Corp. v. American Bus. Ctr., 993 F.2d 1178, 1185 (5th Cir. 1993). For a promise to constitute fraud, the promise must be made with the intent not to fulfill it. Beijing, 993 F.2d at 1185; Airborne Freight Corp. v. C.R. Lee Enters., Inc., 847 S.W.2d 289, 293 (Tex. App. - El Paso 1992, writ denied).

Viewed in the light most favorable to the Bondholders, the claim for fraudulent misrepresentation is again premised on the "Use of Proceeds" section of the Prospectus and the Corporate Defendants' alleged failure to apply the proceeds as indicated therein. As outlined above, even taking the Bondholders' allegations as true, the broad phrasing of that section negates any reasonable inference that use of the proceeds were limited in the way the

Bondholders suggest. For this reason, like the breach of contract claim, the Bondholders fraudulent misrepresentation allegations fail to state a claim upon which relief can be granted. See Jenkins v. Commonwealth Land Title Ins. Co., 95 F.3d 791, 796 (9th Cir. 1996)(dismissal without leave to amend proper where defendant's allegedly false representations were true).

Further, assuming the "Use of Proceeds" language in the Prospectus places an affirmative limitation on the Corporate Defendants' use of the Bond proceeds, the facts alleged in the complaint fail to support any inference that Intelogic Trace, Inc. or any of the individual defendants made the alleged misrepresentation as to the future application of bond proceeds with the

intent, at the time the Prospectus was drafted, not to comply with its provisions. See Airborne Freight Corp. v. C.R. Lee Enter., Inc., 847 S.W.2d at 294 (plaintiff must show promise was false at time made). That is the essence of the Bankruptcy Court's ruling that the Bondholders had failed to plead fraud with particularity. On appeal, the Bondholders do no better at pointing to a factual basis for scienter; they merely argue that they have alleged "a variety of malfeasant acts," (Appellants' Op. Br. at 26), without specifically identifying a single one or explaining how any of the acts demonstrates an intent by any defendant not to comply with the "Use of Proceeds" disclosure. See Tuchman v. DSC Commun. Corp., 14 F.3d 1061, 1068 (5th Cir.

1994)(in pleading scienter, "a plaintiff must set forth specific facts that support an inference of fraud"). Nor have they specified how any one of the individual defendants can be held liable for such fraud. See id. (Rule 9(b) requires particulars of time, place, contents of representation "'as well as the identity of the person making the misrepresentation and what [that person] obtained thereby'")(quoting Tel-Phonic Servs., Inc. v. TBS Int'l, Inc., 975 F.2d at 1139). For these reasons, the Bankruptcy Court did not err in concluding that the Bondholders had failed to plead this fraud claim with particularity or to properly allege scienter.

The Bankruptcy Court further concluded that the fraudulent

misrepresentation claim was barred by the statute of limitations, and this Court agrees. Texas applies a four-year statute of limitations to fraud claims. Kansa Reinsurance Co., 20 F.3d at 1369; Williams v. Khalaf, 802 S.W.2d at 657. Such a claim accrues when the fraud is discovered or when the facts giving rise to the claim reasonably should have been discovered. Kansa Reinsurance Co., 20 F.3d at 1369; Sioux. Ltd. Securities Litig. v. Coopers & Lybrand, 914 F.2d 61, 64 (5th Cir. 1990). As noted above, under the most liberal view of the complaint, the most recent factual occurrence to support this claim was the June 1990 failure of the special committee to bring litigation demanded by a shareholder. (See Compl. ¶ 67.) Consequently, since the complaint was

not filed until October 1994, the fraudulent misrepresentation claim, on its face, is time-barred. The Bondholders have not plead any facts indicating their discovery of the alleged misrepresentation was hampered in any way. See Hoover, 958 F.2d at 744-45. Accordingly, the Court agrees that this claim is barred by the four-year statute of limitations.[7]

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[7] The viability of the Bondholders' contract and fraudulent misrepresentation claims is further undercut by their last-ditch attempt to avoid the time bar by arguing that their claims did not accrue until they purchased the Bonds sometime between 1991 and 1994, an allegation not contained in their complaint. They steadfastly rely on Block v. First Blood Associates, 743 F. Supp. 194 (S.D.N.Y. 1990), in support of this argument. Block involved purchasers in a private placement, not purchasers on the secondary market. Id. at 196. Furthermore, Block holds that "[a] fraud

(...continued)

[7](... continued) case arises upon the making of a misrepresentation causing detrimental reliance." Id. at 198. The court in Block held that "the alleged fraud occurred no later than October 1982 when plaintiffs invested in purported reliance on the report," id. (emphasis added), as that was the latest date indicated in the complaint upon which the representation could have been made to the plaintiffs.

Block is a fraud case, not a breach of contract case. Even assuming that its holding could apply to a contract claim, the Bondholders were not original purchasers of the Bonds. If any breach occurred before their purchase, the Bondholders would obtain their interest subject to any defenses available against the prior holders. See, e.g. McCloskey & Co., Inc. v. Wright, 363 F. Supp. 223, 227 (E.D. Va. 1973)("To allow the assignee to recommence the running of the statute... at the time of the assignment would defeat the purpose and design of the statute as a statute of repose."); Pridgen v. Auto-Owners Ins., Co., 419 S.E.2d 99, 100 (Ga. App. 1992)(claim under insurance contract time-barred, "[s]ince it is well-established that an 'assignee has no more rights under the contract than the assignor would have in dealings with the other contracting party,'... and that an assignee takes the assignment subject to defenses against the assignor");

(continued...)

D. Dismissal of Negligence Claim.

The Bondholders next claim that the Bankruptcy Court erred in dismissing

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[7] (...continued) Cooper v. Hampton, 123 S.W.2d 941,942 (Tex. App.- Amarillo 1938, writ dism'd); cf. Wise v. Anderson, 359 S.W.2d 876, 882 Tex. 1962)(stating converse proposition, that defendant's assignment of contract did not recommence limitations period as to assignee). Therefore, the Bankruptcy Court was correct in calculating the statute of limitations for the contract claim from the date of the breach, not the date of the Bondholders' purchase of the Bonds.

Likewise, as to the fraudulent misrepresentation claim, even if Block holds that this claim did not accrue until the Bondholders made their purchases (which it does not so hold), then the Bondholders complaint, on its face, shows that their reliance on statements in the Prospectus, well after the alleged fraudulent activities they complain of were made public, could not have been reasonable. (See Compl. ¶ 52)(referencing Wall Street Journal report of Intelogic Trace, Inc.'s poor performance, which quoted Defendant Edelman as stating that "he had been doing 'about as badly as you can do' in Europe."); (id. ¶¶ 57, 58)(quoting solicitation statement by a challenger to Edelman in September 1989).

their claim for negligence. The essential elements of a claim for negligence under Texas law are a legal duty owed by one part to another, breach of that duty, and damages proximately caused by the breach. See Leonard v. Aluminum Co. of Am., 767 F.2d 134, 136(5th Cir. 1985); Lucas v. Texas Indus., Inc., 696 S.W.2d 372, 376-77 (Tex. 1984). Thus, to establish liability for negligence, the Bondholders must plead the existence of a duty owed to them by the Corporate Defendants. Leonard, 767 F.2d at 136; Centeq Realty, Inc. v. Siegler. 899 S.W.2d 195, 197 (Tex. 1995). Existence of this duty is a question of law. Centeq Realty, Inc., 899 S.W.2d at 197.

Here, the Bondholders allege that the Corporate Defendants "owed a duty to

[the Bondholders] to use reasonable care in the discharge of their duties so as not to injure [them], i.e., to ensure that the proceeds from the sale of the Bonds were used in the manner in which it was represented they would be used in the...[P]rospectus." (Compl. ¶ 79.) Yet, the Bondholders fail to support that syllogism with any competent legal authority. Although they cite Article 2.31 of the Business Corporation Act, see Tex. Bus. Corp. Act. Ann. art 2.31 (Vernon Supp. 1997)(containing 1989 amendment), and Meyers v. Moody, 693 F.2d 1196 (5th Cir. 1982), cert. denied, 464 U.S. 920 (1983), these authorities deal with the duty of corporate directors to the corporation itself, not to creditors of the corporation, such as the Bondholders. In fact, numerous cases

and commentators have noted the absence of such a duty. See, e.g. Lorenz v. CSX Corp., 1 F.3d 1406, 1418 (3d Cir. 1993); Geren v. Quantum Chem. Corp., 832 F. Supp. at 738 n. 5; Metropolitan Life Ins.. Co. v. RJR Nabisco. Inc., 716 F. Supp. at 1524; Simons v. Cogan, 549 A.2d 300, 303-04 (Del. 1988); Lawrence E. Mitchell, The Fairness Rights of Corporate Bondholders, 65 N.Y.U.L. Rev. 1165, 1175 (Nov. 1990)(recognizing courts' consistent adherence to principle that "corporation owes its bondholders no extra-contractual duties," in arguing for expanded debtholders' rights); 6A Fletcher Cyclopedia of the Law of Private Corporations § 2748 at 199 (1997) ("neither an issuer of debentures nor a controlling shareholder owe to holders

of the company's debt securities duties of the special sort characterized as fiduciary in character").[8] For this reason, the Bondholders' negligence

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[8]The Bondholders alternatively argue that the Corporate Defendants owed them a duty of special care as Intelogic Trace, Inc. approached bankruptcy, relying on Mortgageamerica Corp. v. American Fed. Sav. & Loan (In re Mortgageamerica Corp.), 831 F.2d 97 (5th Cir. 1987), and Tigrett v. Pointer, 580 S.W.2d 375 (Tex. App.-Dallas 1978). The Bondholders do not explain, and this Court fails to see, how Mortgageamerica supports their proposition. That case concerned the effect of a nunc pro tunc order appointing a trustee in bankruptcy on the running of the statute of limitations. See 831 F.2d at 98-99.

Likewise, Tigrett v. Pointer does not support their proposition. Tigrett deals with a garnishment action by a judgment holder to pierce the corporate veil in order to hold the sole stock- holder and other corporations owned by him liable for the judgment. The language of Tigrett, upon which the Bondholders apparently rely, deals with a corporation's duty, as it approaches insolvency, to preserve assets for the benefit of creditors. That duty is discussed because it provides the foundation for fraud necessary to invoke the alter ego doctrine. See 580 S.W.2d at 385-86. It does not apply in this context.

claim allegations fail to state a claim upon which relief can be granted.

In addition, any conceivable negligence claim would be subject to a two-year statute of limitations, running from the time of the act or omission allegedly constituting negligence. Kansa Reinsurance Co., 20 F.3d at 1371. Since the negligence claim is again premised on the Use of Proceeds section of the prospectus, (see Compl. ¶ 79, 80), and the most recent factual allegations occurred in the summer of 1990, as described above, the negligence claim is clearly time-barred.

E. Dismissal of Securities Fraud Claim.

In their opening and reply briefs, the Bondholders make no substantive distinction between their fraudulent

misrepresentation claim and their federal securities fraud claim in arguing that the Bankruptcy Court's ruling should be reversed. In fact, except for passing reference to the securities fraud claim, the briefs focus nearly exclusively on the common law fraudulent misrepresentation claim. Nevertheless, for the same reasons outlined above, the securities fraud claim is subject to dismissal.

No new allegations accompany the statement of this claim. It, like the contract, fraudulent misrepresentation and negligence claim, is premised on the same series of events alleged to demonstrate the Corporate Defendants' violation of the Use of Proceeds clause in the Prospectus. To state a claim for securities fraud under Section 10(b) of

the Securities Exchange Act of 1934, a party must allege "'(1) misstatement or an omission (2) of material fact (3) made with scienter (4) on which the plaintiff relied (5) that proximately caused [the plaintiff's] injury.'" Tuchman v. D.S.C. Communs. Corp., 14 F.3d at 1067 (quoting Cyrak v. Lemon, 919 F.2d 320, 325 (5th Cir. 1990)). Moreover, the strictures of Fed. R. Civ. P. 9(b) apply with equal force to securities fraud claims. Id. at 1068. "Pleading fraud with particularity in this circuit requires 'time, place and contents of the false representations, as well as the identity of the person making the misrepresentation and what [that person] obtained thereby.'" Williams v. WMX Technologies, Inc., 112 F.3d 175, 177 (1997)(quoting Tuchman, 14

F.3d at 1068.[9]

As a threshold matter, the Bondholders ignore clear authority that a prospectus does not supply the basis for a securities fraud claim under Section 10(b) or Rule 10(b)(5) where the parties' relationship is otherwise governed by an indenture. Lorenz v. CSX Corp.., 1 F.3d at 1418; Broad, 642 F.2d at 963; Metropolitan Secs. v. Occidental Petroleum, 705 F. Supp. 134, 141 (S.D.N.Y. 1989).

Second, even assuming that a securities fraud claim premised on the

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[9]Williams likewise disposes of the Bondholders' contentions that the requirements of Rule 9(b) do not require more than notice pleading and that they were improperly denied discovery, through which they could have better articulated their claims. See id. at 178.

Prospectus is cognizable, for the reasons already explained above, the "Use of Proceeds" section, read in its entirety, contains almost no limitation on Intelogic Trace's application of the Bond proceeds and certainly no guarantee that new acquisitions of computer service-related businesses would occur. Therefore, the Bondholders have not alleged a "misstatement or omission" upon which a securities fraud claim can be based.

Third, making yet another assumption that the "Use of Proceeds" section can be considered false or misleading, the element of scienter is missing. Although the Bondholders point to a series of events that post-date the issuance of the Prospectus, they fail to identify how these events demonstrate an intent

to deceive at the time the Prospectus was prepared. Their burden is to show that the Corporate Defendants' published materially false information with culpable intent. That requires them to set forth "specific facts to support an inference of fraud" demonstrating motive or conscious behavior to defraud. Lovelace, 78 F.3d at 1018-19. "[C]orporate mismanagement does not, standing alone, give rise to a 10b-5 claim, and mea culpa does not sufficiently satisfy the scienter requirements of pleading in securites fraud cases unless it is shown to relate to activities that have a definable nexus or relationship with the sale or purchase of a security." Tuchman, 14 F.3d at 1070. The Bondholder's allegations fail to meet this basic

requirement.

Finally, even making the numerous inferential leaps required to assume a violation of federal securities law, such a claim would be barred by the statute of limitations. In Lamf, Pleva. Lipkind, Prupis & Petigrow v. Gilbertson, the Supreme Court held that federal law supplies a two-tiered limitations period applied to claims under §10(b) and Rule 10(b)(5). 501 U.S. 350, 361 (1991). Under Lamf, such claims must be brought within one year after the discovery of facts constituting the violation and within three years after such violation. Id. This period is not subject to equitable tolling because it is "fundamentally inconsistent with the 1- and 3- year structure." Id. at 363. Thus, the "outside limit" by which the

Bondholders must have brought their securities fraud claim was within three years after the alleged violation. Id. As noted earlier, the latest event alleged in the complaint to support any of the claims occurred on June 18, 1990, when a special committee of Intelogic Trace, Inc.'s directors declined to institute litigation, but the complaint was not filed until more than four years later. Therefore, the securities-fraud claim is likewise time-barred.

F. Denial of Leave to Amend.

Finally, the Bondholders argue that the Bankruptcy Court erred in not granting them leave to amend their complaint. The Corporate Defendants respond that this ruling was appropriate, as amendment would be futile. This Court agrees.

In Lowrey v. Texas A& M University System, the Fifth Circuit explained that they abuse of discretion standard by which an appellate court considers the denial of leave to amend is tempered by Fed. R. Civ. P. 15(a)'s proviso that "leave shall be freely given when justice so requires." See 117 F.3d at 245. But Lowrey and other cases recognize that leave to amend is properly denied where it would be futile to do so. See id.; FDIC v. Conner, 20 F.3d 1376, 1385 (5th Cir. 1994). In this case, the Bankruptcy Court implicitly concluded that it would be futile to permit the Bondholders to amend their complaint because they had no viable claims against the Corporate Defendants. This Court agrees.

The breach of contract claim is

premised on a document-the Prospectus-that does not constitute a contract between the parties. The proper document-the Indenture- contains an exhaustion provision with which the Bondholders never attempted to comply and which therefore bars their common-law contract, fraud and negligence claims. The contract claim additionally was not brought within two years of the alleged breach and is therefore time-barred. Likewise, the fraudulent misrepresentation and securities fraud claims, also premised on the "Use of Proceeds" clause of the Prospectus, fail to state colorable causes of action. The language of that clause simply does not bear out the Bondholders' interpretation; in fact, it expressly excludes their interpretation by

disclaiming the limitation they espouse. In addition, the Bondholders fail to particularize their allegations as to scienter for in these claims. Lastly, the negligence claim is deficient because the Bondholders failed to allege a duty running to them from the Corporate Defendants. This claim is also barred by the statute of limitations.

In the hearing on the motion to dismiss, the Bankruptcy Court provided counsel for the Bondholders every opportunity to articulate how he might state a claim under any theory colorably growing from the complaint, but counsel was unable to do so. On appeal, the Bondholders employ the same artifice as below, by changing the premise of their argument each time a fatal flaw is revealed. This Court wholeheartedly

agrees with the Bankruptcy Court's analogy to the schoolyard at recess, quoted in Section I of this opinion. In these circumstances, the Court concludes that the Bankruptcy Court did not abuse its discretion in denying leave to amend.

III. Conclusion.

IT IS ORDERED THAT the Bankruptcy Court's judgment granting the Corporate Defendant's motion to dismiss the Bondholders' First Amended Complaint is AFFIRMED; and

IT IS FURTHER ORDERED THAT the Bondholders' motion for precedence of hearing and/or decision on pending appeal, filed June 9, 1997, is DENIED as moot.

SIGNED and ENTERED this 16 day of October, 1997.

S/
ORLANDO L. GARCIA
UNITED STATES DISTRICT JUDGE

[U.S. COURT OF APPEALS
FILED
FEB 22 1999
CHARLES R. FULBRUGE III CLERK]

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT COURT

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No. 97-50932

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D.C. Docket No. SA-95-CV-1007

In The Matter Of: INTERLOGIC TRACE, INC.

Debtor

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HOWARD SACHS, NIBCO NEVADA, INC.; KAREN SACHS; CLAUDIA SACHS; HOWARD YONET; JOSEPH CORDA; TOMA CORDA; ELIZABETH J. SAMPSON, and Associates; YONY PROPERTIES, INC.; HENRI YONET; PAUL YONET; LARRY WAYNE; ANNE WAYNE; NOAM SCHWARTZ; MARION BLACKBURN; LOIS ESFORMES; MARY ANN MCCAIN; STAN COHEN; CAROL SEIDEN; SACHS LIVING TRUST; HERBERT H. EVELOFF, M.D.; PETER KALTMAN; NEO CONSTRUCTION, INC; HERBERT H EVELOFF, M.D., FAYE EVELOFF; GARY AUSTIN; KAY F. GERHARD; L.F.I. RETIREMENT TRUST; GARY POLLACK

Appellants

v.

INTERLOGIC TRACE, INC; ASHER B. EDELMAN; CLARK R. MANDIGO; LEON BOTSTEIN; HENRY G.

CISNEROS; DANIEL R. KAIL; BURTON LEHMAN; MICHAEL D. SCHULTZ; DWIGHT D. SUTHERLAND

Appellees

Appeal from the United States District Court for the Western District of Texas, San Antonio.

Before HIGGINBOTHAM, BENAVIDES, and DENNIS, Circuit Judges.

J U D G M E N T

This cause came on to be heard on the record on appeal and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the judgment of the Bankruptcy Court in this cause is affirmed in part and reversed in part, and the cause is remanded to the Bankruptcy Court for further proceedings in accordance with the opinion of this Court.

IT IS FURTHER ORDERED that appellees pay to appellants the costs on appeal to

be taxed by the Clerk of this Court.

ISSUED AS MANDATE: APR 06 1999

[U.S. COURT OF APPEALS
FILED
FEB 22 1999
CHARLES R. FULBRUGE III CLERK]

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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No. 97-50932

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In The Matter Of: INTELOGIC TRACE, INC.

Debtor,

HOWARD SACHS, NIBCO NEVADA, INC.; KAREN SACHS; CLAUDIA SACHS; HOWARD YONET; JOSEPH CORDA; TOMA CORDA; ELIZABETH J. SAMPSON, and Associates; YONY PROPERTIES, INC.; HENRI YONET; PAUL YONET; LARRY WAYNE; ANNE WAYNE; NOAM SCHWARTZ; MARION BLACKBURN; LOIS ESFORMES; MARY ANN MCCAIN; STAN COHEN; CAROL SEIDEN; SACHS LIVING TRUST; HERBERT H. EVELOFF, M.D.; PETER KALTMAN; NEO CONSTRUCTION, INC; HERBERT H EVELOFF, M.D., FAYE EVELOFF; GARY AUSTIN; KAY F. GERHARD; L.F.I. RETIREMENT TRUST; GARY POLLACK

Appellants,

versus

INTELOGIC TRACE, INC; ASHER B. EDELMAN; CLARK R. MANDIGO; LEON BOTSTEIN; HENRY G. CISNEROS; DANIEL R. KAIL; BURTON LEHMAN;

MICHAEL D. SCHULTZ; DWIGHT D. SUTHERLAND

Appellees.

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Appeal from the United States District Court for the Western District of Texas (SA-95-CV-1007)

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Before HIGGINBOTHAM, BENAVIDES, and DENNIS, Circuit Judges.

PER CURIAM:*

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*Pursuant to 5th CIR. R. 47.5, the Court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5th CIR. R. 47.5.4.

The appellants are thirty individual and institutional holders of subordinated debentures ("Bondholders") who filed a complaint against the bond issuer, Intelogic Trace, Inc. ("Intelogic"), and eight former members of Intelogic's board of directors ("Directors"). The Bondholders filed the complaint as an

adversary proceeding under Intelogic's then pending Chapter 11 bankruptcy case. They alleged that Intelogic had violated commitments made to the Bondholders in the bond prospectus ("Prospectus") by squandering bond proceeds on unwise investments. On motion by Intelogic and the Directors, the bankruptcy court dismissed the Bondholders' complaint and denied the Bondholders' motion for leave to file an amended complaint. The district court affirmed the bankruptcy court's judgment and the Bondholders now appeal from that decision.

We affirm the district court's decision insofar as it upheld the dismissal of the Bondholders' complaint. That complaint alleged that Intelogic's failure to abide by commitments made to the Bondholders in the Prospectus entitled

the Bondholders to relief for: (1) breach of contract; (2) intentional misrepresentation; (3) negligence; and (4) securities fraud.[1] Because the Prospectus was not a contract between the Bondholders and Intelogic, because the Prospectus did not contain any restrictive representations regarding the manner in which the proceeds would be used, and because the Prospectus did not establish any statutory or common law duty between Intelogic and the Bondholders, all of those claims were properly dismissed under Federal Rule of Civil Procedure 12(b)(6) for failing to state claims upon which

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[1]The complaint also asserted two other claims under state and federal securities laws. Because one of those claims was voluntarily dismissed by the Bondholders and the bankruptcy court's dismissal of the other was not appealed, neither are considered here.

relief could be granted. Moreover, they were each barred by the applicable statute of limitations.

We reverse the district court's decision insofar as it upheld the denial of the Bondholders' motion for leave to file an amended complaint. Federal Rule of Civil Procedure 15(a) provides that leave to amend a pleading "shall be freely given when justice so requires." Although we review a trial court's decision to deny leave only for an abuse of discretion, "[i]ts discretion...is not broad enough to permit denial if the court lacks a substantial reason to do so." Southmark Corp. v. Schulte Roth & Zabel (In re Southmark Corp.) 88 F.3d 311, 314 (5th Cir. 1996). It is within the trial court's discretion to deny leave when any amendment would be futile. See FDIC v.

Conner, 20 F.3d 1376, 1385 (5th Cir. 1994).

The Bondholders argued before the bankruptcy court that, if their claims under the Prospectus were no viable, the court should permit them to amend their complaint to include claims under the indenture agreement ("Indenture"). Both the bankruptcy court and the district court rejected the Bondholders' argument, finding that any amendment to include claims under the Indenture would be futile. The district court based its conclusion on the Indenture's "no action" exhaustion provision which required that bondholders allow the indenture trustee an opportunity to act upon any bondholder complaints before the bondholders would be permitted to file suit. Because the Bondholders had not presented their complaints to the indenture trustee, the

district court reasoned that any claims based on the Indenture would be barred by that requirement, and that the bankruptcy court was thus correct in denying leave. We disagree.

Although the Indenture's "no action" provision bars many of the Bondholders' potential claims, it does not bar all of them. Specifically, under section 7.07 of the Indenture, claims for nonpayment of interest are exempted from the "no action" exhaustion requirement. Furthermore, unlike the Bondholders other potential claims, a claim for nonpayment of interest does not appear to be barred by the statute of limitations as the Bondholders filed suit in October, 1994, less than three months after Intelogic first failed to make their interest payments under the debentures. Therefore, it would not have

been futile for the Bondholders to amend their complaint to include a claim for nonpayment of interest under the Indenture.

The district court declined to consider this argument, finding that the Bondholders had not properly raised the issue before the bankruptcy court. In the brief in which they requested leave from the bankruptcy court, however, the Bondholders raised nonpayment of interest as a basis for relief at several points, including the section discussing breach of contract:

> The indenture agreement provides ... that Intelogic will pay principal and interest on the securities in the manner provided by the securities themselves. ... Defendants' actions have caused this provision to be breached. Interest has not been paid according to those terms. Defendants' actions have

> prevented plaintiffs from receiving the fruits of their contract.

We find that the Bondholders did adequately place the issue of nonpayment of interest before the bankruptcy court. The district court thus erred in finding no abuse of discretion in the denial of the Bondholders' motion for leave to amend their complaint to include a claim based on the nonpayment of interest.

Such a claim, however, would be futile if brought against the Directors. The Indenture incorporates language from the debenture that limits the liability of past or present directors for any obligations of Intelogic under the Indenture or debenture. The Bondholders have failed to provide any theory explaining how the Directors could nonetheless be liable for Intelogic's

nonpayment of its interest obligations under the debenture. We therefore limit our reversal of the district court's decision such that the Bondholders on remand are only permitted to amend their complaint to include a claim against Intelogic, and not the Directors.

For the foregoing reasons, we AFFIRM in part, REVERSE in part, and REMAND to the bankruptcy court for further proceedings consistent with this decision.

[U.S. COURT OF APPEALS
FILED
MAR 29 1999
CHARLES R. FULBRUGE III CLERK]

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT COURT

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No. 97-50932

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In The Matter Of: INTERLOGIC TRACE, INC.

Debtor

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HOWARD SACHS, NIBCO NEVADA, INC.; KAREN SACHS; CLAUDIA SACHS; HOWARD YONET; JOSEPH CORDA; TOMA CORDA; ELIZABETH J. SAMPSON, and Associates; YONY PROPERTIES, INC.; HENRI YONET; PAUL YONET; LARRY WAYNE; ANNE WAYNE; NOAM SCHWARTZ; MARION BLACKBURN; LOIS ESFORMES; MARY ANN MCCAIN; STAN COHEN; CAROL SEIDEN; SACHS LIVING TRUST; HERBERT H. EVELOFF, M.D.; PETER KALTMAN; NEO CONSTRUCTION, INC; HERBERT H EVELOFF, M.D., FAYE EVELOFF; GARY AUSTIN; KAY F. GERHARD; L.F.I. RETIREMENT TRUST; GARY POLLACK

Appellants

v.

INTERLOGIC TRACE, INC; ASHER B. EDELMAN; CLARK R. MANDIGO; LEON BOTSTEIN; HENRY G. CISNEROS; DANIEL R. KAIL; BURTON LEHMAN;

MICHAEL D. SCHULTZ; DWIGHT D. SUTHERLAND

Appellees

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Appeal from the United States District Court for the Western District of Texas, San Antonio

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ON PETITION FOR REHEARING EN BANC

(Opinion 2/22/99 , 5 Cir., _____, _____ F.3d _____)

Before HIGGINBOTHAM, BENAVIDES, and DENNIS, Circuit Judges.

PER CURIAM:

(√) Treating the Petition for Rehearing En Banc as a Petition for Panel Rehearing, the Petition for Panel Rehearing is DENIED. No member of the panel nor judge in regular active service of the court having requested that the court be polled on Rehearing En Banc (FED. R. APP. P. and 5TH CIR. R 35), the Petition for Rehearing En Banc is DENIED.

( ) Treating the Petition for Rehearing En Banc as a Petition for Panel Rehearing, the Petition for Panel Rehearing is DENIED. The court having been polled at the request of one of the members of the court and a majority of the judges who are in regular active service not having voted in favor (FED. R. APP. P. and 5TH CIR. R. 35), the Petition for Rehearing is DENIED.

ENTERED FOR THE COURT:

S/_____
United States Circuit Judge

REHG-6

CLERK'S NOTE:

SEE FRAP AND LOCAL RULES 41 FOR STAY OF THE MANDATE

## STATUTES INVOLVED IN THE CASE

Federal Rules of Civil Procedure, Rule 9(b):

> "**Fraud, Mistake, Condition of the Mind.** In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally."

Federal Rules of Bankruptcy Procedure, Rule 7009:

> "**Fraud, Mistake, Condition of the Mind.** In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally."

Federal Rules of Civil Procedure, Rule 12(b)(6):

> "**How Presented.** Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third party claim, shall be asserted in the responsive

pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion...(6) failure to state a claim upon which relief can be granted...A motion making any of these defenses shall be made before pleading if a further pleading is permitted. No defense or objection is waived by being joined with one or more other defenses or objections in a responsive pleading or motion...If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such motion by Rule 56."

Federal Rules of Bankruptcy Procedure, Rule 7012:

"**How Presented.** Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or

third party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion...(6) failure to state a claim upon which relief can be granted...A motion making any of these defenses shall be made before pleading if a further pleading is permitted. No defense or objection is waived by being joined with one or more other defenses or objections in a responsive pleading or motion...If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such motion by Rule 56."